FINAL DRAFT
LONG – TERM FINANCIAL PLAN POLICY

FINAL DRAFT - ANNUAL BUDGET OF
Bitou Municipality

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EXECUTIVE SUMMARY

"The economy is a very sensitive organism."
Hjalmar Schacht[1]

1. The outcome of this assignment makes a contribution towards the 10 year long term financial plan of the Bitou Local Municipality. It is not "THE PLAN" but informs the plan that the municipality has to prepare and adopt.

2. The Independent Financial Assessment of the Bitou LM was prepared by INCA Portfolio Managers and updated with the latest financial information as at 30 June 2014. The report is attached as Annexure 1. This report also includes a summary of the information on demography, economy and household infrastructure of the Bitou LM.

3. We have reviewed the Integrated Development Plan ("IDP") and sector master plans of the municipality and conducted interviews with the management of the municipality. This was done with the purpose of identifying material matters that could impact on the long term financial sustainability of the municipality as well as inform proposals regarding future policy directions.

4. We modelled the municipality's cash needs against the revenues it can expect to generate based on the economy and population of the sub-region, in an attempt to determine the affordability of future capital expenses.

5. A scenario analysis was undertaken and the results are illustrated in the graph below:

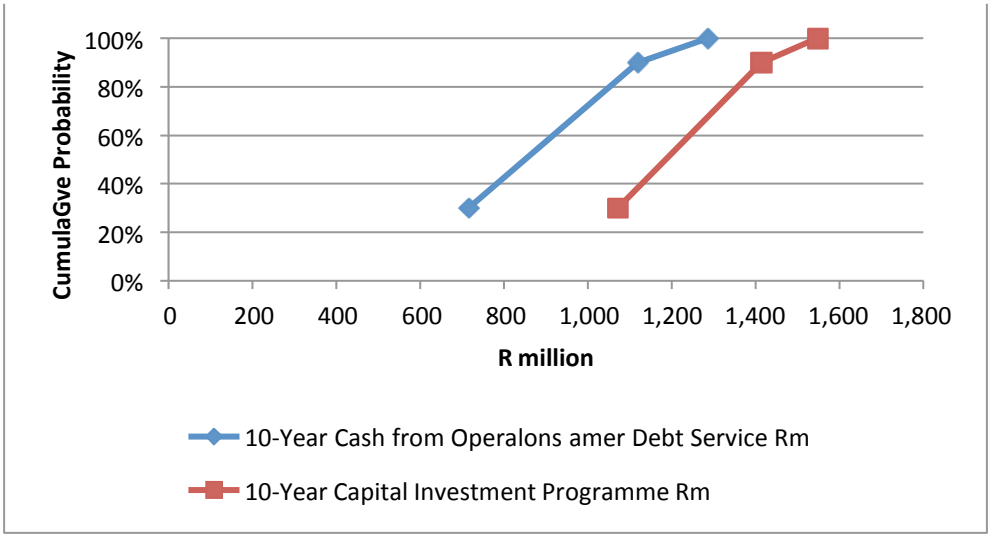
   We estimate that in the **Base Case Scenario**, with a probability of occurrence of 60%, the municipality will, over a 10 year period, generate cash from operations after debt service of R1.1 billion and will be able to invest in a capital programme of R1.4 billion.

   In an **Upside Scenario**, with a probability of occurrence of 10%, the municipality will be able to generate cash from operations after debt service of R1.3 billion and will be able to invest in a capital programme of R1.5 billion.

   In the **Downside Scenario**, with a probability of occurrence of 30%, the 10 year cash generated after debt service is R0.7 billion and the capital investment programme is limited to R1.1 billion.

[1] http://www.brainyquote.com/quotes/quotes/h/hjalmarsch309075.html#Z2oMws2fxdciuiIs.99

GRAPH 1: CUMULATIVE PROBABILITIES OF OUTCOME OF SCENARIO ANALYSIS



6. After the completion of the updated financial assessment we conclude as follows:

6.1. The high dependency by the local economy on tourism spend holds inherent risks, and any efforts by the municipality to diversify the economy should be lauded.

6.2. The relative low economic growth rate during the last 5 years together with a population growth rate that is the highest of all municipalities in the Eden District is of particular concern and requires active intervention of all stakeholders in an attempt to promote economic growth in future.

6.3. The regional economy and the ability of households to pay for services delivered by the municipality, rates the Bitou LM as a "Very High" risk on IPM's Municipal Revenue Risk Indicator scale. There is a very high risk that the municipality will not be able to generate sufficient own revenue and will increasingly be dependent on subsidies and grants from other spheres of government.

6.4. The municipality has installed infrastructure that provides a high level of service to its residents. This is borne out by a relatively high Infrastructure Index of 0.83 and relatively low levels of backlogs. It needs to be emphasised however that the high level of service infrastructure does not necessarily imply that the condition of the infrastructure is acceptable. Asset management requires significant budgetary allocations to repair and maintain as well as replace infrastructure at the appropriate time in future.

6.5. There is a gap between the level of infrastructure provided and the percentage of households able to pay for that infrastructure and the concomitant services. This would indicate at affordability challenges in future.

6.6. The high percentage Non-Revenue Water is of particular concern and requires corrective action.

6.7. Based on the increasing trend in the provision for longer term Employee Benefits, it may be beneficial for Bitou to review the terms of employment, consider the longer term financial implications thereof and calculate its affordability in the longer term. In the interim the current portion for this long term liability needs to be provided for and cash backed.

6.8. The updated Historic Financial Assessment is attached as Annexure 1.

6.9. Pursuant to the review, we conclude that there is an improvement in the management of Bitou Municipality's financial affairs. This is particularly noticeable in the reduction of the shortfall of cash reserves to cover the statutory requirements, improvement of the Current Ratio to 1.6:1 from 1.0:1 a year ago as well as an improvement in the credit rating within the BBB band.

6.10. Although there is not a radical change, most indicators show positive improvements. Bitou Municipality has posted a higher Total Accounting Surplus, but a reduced cash operating surplus. Debtors' collection levels were maintained, external gearing is within acceptable benchmarks and in the past financial year the municipality has increased its capital spending.

6.11. A significant amount of the increase in Total Revenue was due to an increase of approximately R25 million in Capital Grants and R24 million in Fines.

6.12. Gross Consumer Debtors has increased slightly but Debt Impairment increased substantially by an amount of R23 million, an increase of 59%. In the light of the increase in Fines, the increase in Debt Impairment is comprehended.

6.13. In the light of the uncertain electricity supply and future revenues that can be generated from the sale of electricity, it is noticeable that the proportion that these revenues contribute to Total Revenues has declined in 2013/14, but that the revenue item that is under the control of the municipality, viz. Property Rates has increased proportionally. We see this as a positive development.

6.14. The Total Expenditure increased largely as a result of a 23% increase in the Salaries and Wages Bill, resulting in this expenditure item now constituting 34% of Total Expenditure. From this finding we deduct that the Municipality has not implemented any staff rationalisation programmes.

6.15. Overall there was an improvement in the liquidity of the municipality. There does however remain room for continued improvement in liquidity, which will stand in support of the municipality's longer term financial viability - if maintained.

7. We recommend that the outcome of our assessments, discussions with Executive Management of the Municipality and Capital Investment Model are adopted for inclusion in a long term financial strategy:

7.1. The municipality can best serve the objective of diversifying the economy, drawing investors and thereby curbing unemployment by providing exceptional high level of services, e.g. by reducing turnaround times for the approval of plans, reducing response times and generally provide its core functions to the best of its abilities. Providing services proactively by anticipating where development will occur, will further add to improved service delivery.

7.2. Promote the development of medium income housing.

7.3. Cash generated from Operational Activities should be strengthened through stabilisation of the collection rate to at least 97% and managing operating expenditure effectively in relation hereto. Cash generated is to be prudently appropriated to the restoration of Liquidity and Capital Replacement Reserve.

7.4. Increase the level of liquidity to a ratio of 2:1. (In terms of the level of cash and investments held, Bitou has a shortfall of R 39 million to meet the Minimum Liquidity Required.)

7.5. A cash backed liquidity reserve of at least one month's operational expenses should be maintained in addition to maintaining reserves for unspent conditional grants, short term provisions and cash backed reserves.

7.6. The Capital Replacement Reserve is annually increased in small increments, this is a prudent practice. However the use of these funds should be guided in a Liquidity, Funds and Reserves Policy to ensure the funds are not depleted.

7.7. Adopt the objective - and work towards - transferring depreciation charges to a cash backed Capital Replacement Reserve.

7.8. Sufficient provisions need to be made in cash for the escalation in short term provisions for employee benefits.

7.9. External gearing should not be increased to levels higher than 30% and therefore levels would first need to be reduced and will place a cap on short term access to External Finance.

7.10. Ensure that value for money is received from contractors, by thoroughly scrutinising tenders and monitoring the implementation of contracts.

7.11. Strengthen the institutional capacity to ensure that billing accuracy is improved and validate the integrity of the consumer database.

7.12. Revenue should be increased by approximately 2 percentage points above the CPI rate p.a. on average through a combination of increased sales of services and increase in tariffs.

7.13. Explore accessing the following revenue sources:

- Full cost recovery of all airport services (e.g. weekend fire services) through an increase of landing fees, parking fees and other/new relevant fees
- Add a levy to property rates to build up resources to counter the deterioration through a lack of maintenance of non-revenue generating infrastructure, viz. roads and stormwater
- Charge out the municipality's excess resources to outside parties at profitable rates, e.g. infrastructure for wireless communication
- Consider the potential of metering and billing of individual tenants separately at tariffs higher than the tariffs for bulk metering of developments
- Implement a levy on homeowners of RDP housing to cater for the higher than nationally required level of service delivered to these households

7.14. Expenses must be managed prudently and annual increases must be reflected in tariffs.

7.15. Staff Costs are anticipated to escalate even further and already comprise 33% of Total Operating Expenditure. A cost vs. benefit analysis needs to be performed to effectively manage the required resources against the cost thereof. As any efficiency gains would benefit Bitou in the longer-term.

7.16. The municipality is advised to adjust its Repairs and Maintenance budget upwards, by preferably, at least 10 percentage points above CPI p.a. in an attempt to achieve the MFMA Circular 71 targets of 8% of the carrying value of Property, Plant and Equipment in the longer term.

7.17. In the recent past Water & Electricity losses were exceptionally high and the municipality is advised to implement action plans to curb these losses. Put measures in place, consisting of engineering solutions (meters, valves, etc.), education programmes and stricter credit control to prevent excessive water & electricity losses.

7.18. Target the following expenditure items in an attempt to reduce costs:

- Financial support to the Tourism Office
- Financial contribution to ad hoc programmes and events that are not included in the municipality's core functions
- Overtime and standby pay
- Consider the rationalisation of staff in the Law Enforcement-, Waste Management- and Finance Departments

7.19. Although the 10-year waste management contract with Eden DM is only in its infancy, all possible alternatives should be investigated with the aim of minimising expenditure in the long term.

7.20. In the light of the additional burden of performing the fire services normally expected of a District municipality (viz. bush fires), protecting vulnerable informal settlements and weekend services at the airport, specific attention to the resourcing of this function is required.

7.21. Whereas human capital consultants are more qualified to make recommendations related to human resources, management has identified the following: (i) review and rationalise the human resources complement by ensuring that critical vacancies are filled and non-essential posts made redundant, (ii) optimise the use of internal capacity and external service providers (contractors), (iii) promote training and mentorship programmes and (iv) consider multi-skilling of staff.

7.22. The support that the municipality is expected to provide to its indigent population is estimated to be greater than the amount of equitable share that it can recover from the State. This must be addressed in the short term through a maximisation of operational grants and in the medium term a rationalisation of the service level delivered to households that cannot afford the services.

7.23. Support to indigents should be addressed at two levels:

- In the relationship between the Municipality and the beneficiary household: (i) validate the indigent register and establish if recipients do indeed qualify for free basic services, (ii) re-look the application process and the supporting documentation required to ensure that recipients do not unlawfully try and qualify for these subsidies (iii) utilise third party databases to ascertain if the information in these databases corresponds with information provided by the applicant and (iv) review and amend where necessary the indigent policy to contain any cash shortfall (v)

ensure accurate costing to better understand the support that the municipality is providing.

- In the relationship between the Municipality and other spheres of government: (i) ensure that the municipality receives all grants and subsidies to which it is entitled, (ii) advocate for more support from national government for support towards operational expenses associated with the high rate of influx of indigents to the region.

7.24. Implement integrated asset management where expenditure on new infrastructure, replacement infrastructure and repairs and maintenance expenditure are optimised. It is also proposed that within the next 4 years, the asset register progress from merely an accounting tool to a comprehensive asset management system.

7.25. It is proposed that asset components are clearly identified and their location recorded, that the costs of repairs and maintenance, rehabilitation and replacement are properly accounted for and recorded against the relevant asset component.

7.26. Introduce a comprehensive costing system, which captures the actual costs incurred on the maintenance, replacement and creation of asset components, including labour, materials and equipment costs.

7.27. The municipality needs a consolidated municipal infrastructure plan including long term capital expenditure budgets. This plan can then be updated annually with the latest information on asset replacement and provision of new infrastructure.

7.28. In nominal terms the municipality can afford a 10-year capital investment programme of app. R 1 413 million. The demand already exceeds this amount by approximately R1 billion and a clear prioritisation of infrastructure projects must be undertaken. The municipality should not neglect the replacement of its existing assets and a prioritisation should compare the need for new infrastructure with the need of replacing existing infrastructure.

8. We also propose that each of these recommendations be allocated to staff to implement as part of their key performance measures and that the Municipal Manager oversees this cross cutting “Project”.

1. INTRODUCTION

1. This report is the outcome of an assignment undertaken by INCA Portfolio Managers ("IPM") for the Bitou Local Municipality. The objective of the assignment is to make a contribution towards a proposed 10-year long term financial plan of the municipality.

2. This assignment was completed in 2014 with the financial information up to 30 June 2013 and updated in 2015 with the financial information as reported on 30 June 2014.

3. Based on a review of the Revised Integrated Development Plan of the municipality (2014/2015 – Draft), the Water Services Development Plan ("WSDP") for 2014/2015 and various other documents made available by the municipality as well as interviews with the management of the municipality we reflect on the capital investment requirements as well as proposed future policy directions of the municipality. The capital demand, consisting of asset replacement costs (quantified pursuant to an analysis of the Asset Register) and new capital investments (quantified mainly in the WSDP), is evaluated against the capacity of the municipality to afford these future capital expenses. In the evaluation we estimate the potential future municipal revenues based on the economy and population of the sub-region. These revenues will in turn inform the funding mix that the municipality can access to finance its future capital needs.

4. The process followed in 2014 is illustrated below:

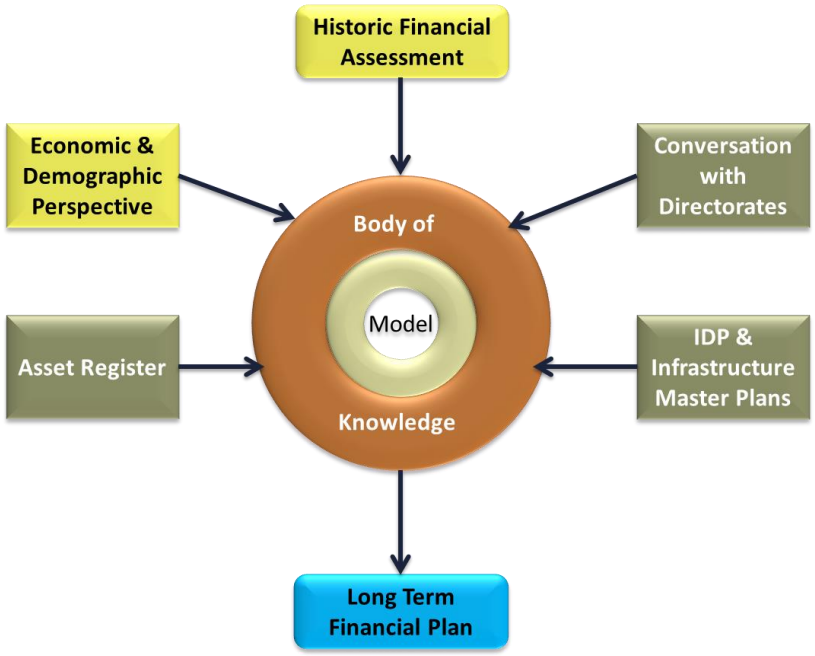


FIGURE 1: LONG TERM FINANCIAL PLAN - PROCESS

5. This latest (2015) review consists of (i) an update of the historic financial assessment with the latest financial information as reported in the AFS of 30 June 2014 and an update of the Economic, Demographic and Household Infrastructure Perspective and (ii) a re-run of INCA's proprietary Capital Investment Model to determine future capital expenditure affordability based on the latest financial information and revised assumptions.

6. This updated review does not include a review of the Asset Registers, IDP and Infrastructure Master Plans. We also did not have another round of conversations with the Directorates. The information on these topics as reported on in this report relates to the information obtained in 2014.

7. In our conclusion and recommendations we reflect on the outcome of the studies in this report, highlight some of the material issues identified and make very specific proposals regarding the 10-year financial plan, financial strategies and policies to be adopted.

8. The following sources of information have been scrutinised and taken into consideration in the conclusion of the Independent Financial Analysis and the development of this Long Term Financial Plan:

    a. Financial Statements from 2003/04 to 2013/14
    b. Medium Term Revenue and Expenditure Framework: 2013/14 to 2016/17
    c. Revised Integrated Development Plan 2014/15
    d. Water Services Development Plan ("WSDP") for 2014/2015
    e. Various other documents (where relevant)
    f. Economic data extracted from IHS Global Insight ReX

2. PERSPECTIVE

9. A detailed *UPDATED Independent Financial Assessment Against the Background of the Municipality's Demographic, Economic & Household Infrastructure Position*, April 2015, is attached hereto as Annexure 1. The paragraphs below provide a summary of the perspectives that will inform the proposals and recommendations in this report.

Spatial & Demographic Perspective

10. Bitou has a total population of 52 379 (2013) people which represents 9% of the population living in the Eden DM. This is the second lowest population figure of the seven municipalities in the district.

11. Bitou's current population growth rate of 4.0% p.a. is the highest of all municipalities in Eden.

12. Bitou's current annual per capita income is R 55 139, which is the third lowest of the seven municipalities in Eden.

13. The economic active population[2] in Bitou is 48.4% of the population. The official unemployment rate is 33.1%, which is the highest unemployment rate of the seven municipalities in the District.

Economic Perspective

14. Bitou's total gross economic value add ("GVA"), which reflects the monetary value of the local economy is R 2.26 billion per annum in current prices or R 1.83 billion in constant (2005) prices with the following sectors making a contribution:

TABLE 1: SECTOR SHARE OF TOTAL: BITOU LM

	2004	2013
1 Agriculture	5.2%	4.6%
2 Mining	0.0%	0.0%
3 Manufacturing	13.0%	14.1%
4 Electricity	2.1%	2.6%
5 Construction	7.2%	11.3%
6 Trade	25.3%	32.3%
7 Transport	3.8%	4.7%
8 Finance	33.0%	20.2%
9 Community services	10.3%	10.2%

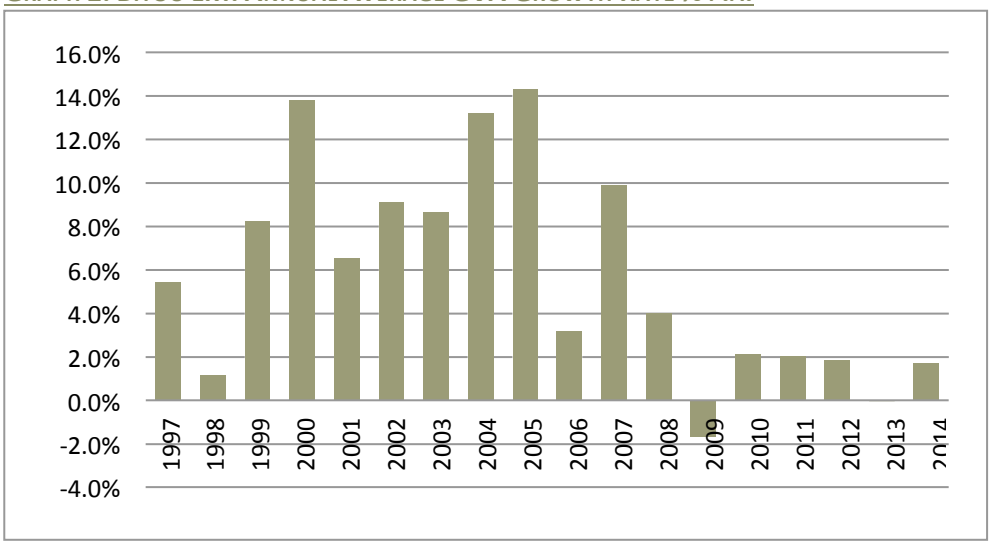
[2] Economically Active Population (EAP): The economically active population (EAP) is defined as the number of people who are able, willing and who are actively looking for, work and who are between the ages of 15 and 65. It thus includes both employed and unemployed people.

15. Trade and Finance together contribute more than 50% of the local economy - both sectors serving the tourism industry.

16. Currently the amount of spending related to tourism (leisure, business, people visiting family and friends and other) is in the order of R2.4 billion per annum, which represents an unprecedented 107% of the GVA of Bitou. (This excludes any capital expenditure such as the construction of holiday homes.)

17. The average annual GVA growth rate for the period since 1997 is 6.3% p.a., but with the cyclical characteristics that the national economy is subjected to. The average growth rate in the past 5 years was a very low 0.8% p.a.

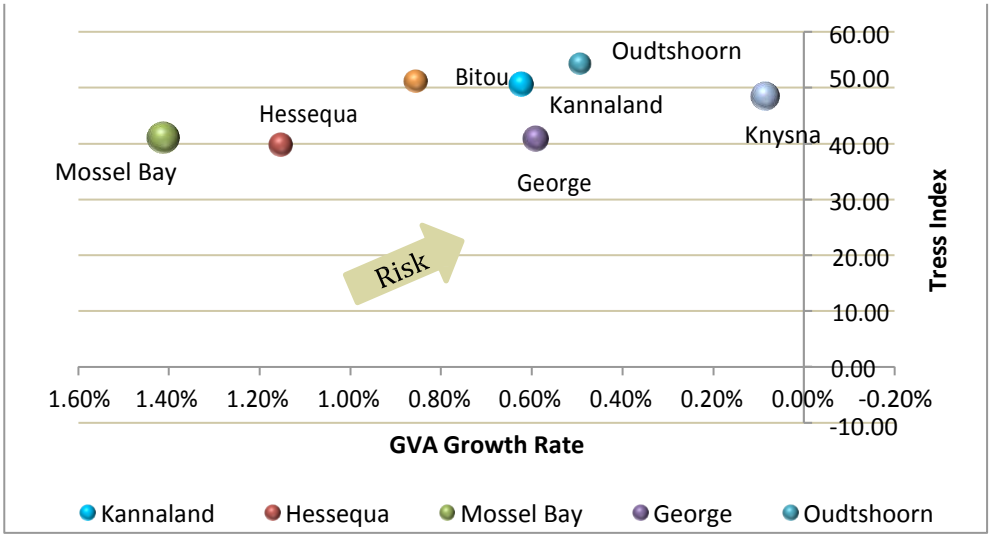
GRAPH 2: BITOU LM: ANNUAL AVERAGE GVA GROWTH RATE % P.A.



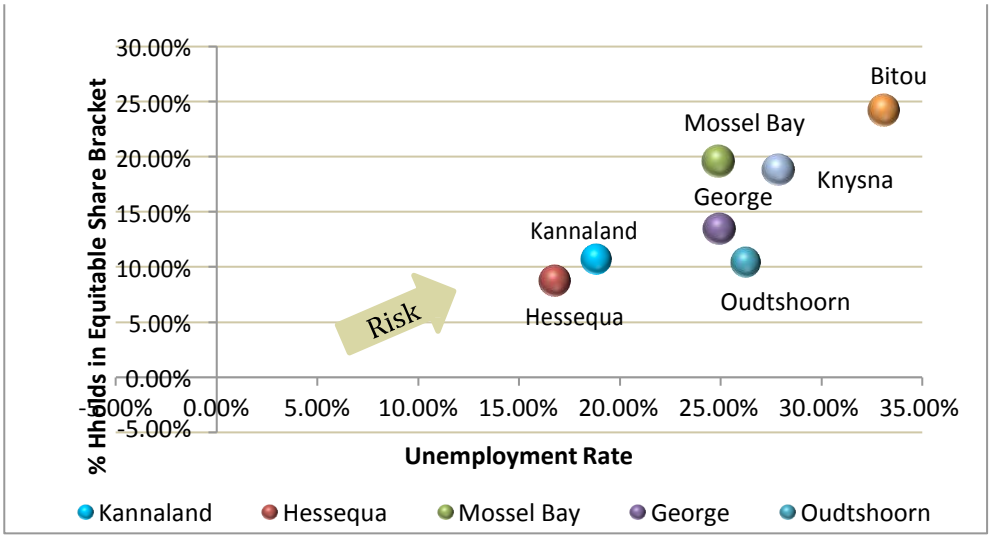
18. IPM has developed the Municipal Revenue Risk Indicator ("MRRI"), which measures the risk of a municipality to generate its own revenues. This risk is on the one hand a function of the economy (GVA, Tress Index and GVA growth rate) and on the other a function of households' ability to pay (measured by the % of households with income in the equitable share bracket, unemployment rate and Human Development Index).

19. The regional economy and the ability of households to pay for services delivered by the municipality, rates the Bitou LM as a "Very High" risk on IPM's Municipal Revenue Risk Indicator scale. There is a very high risk that the municipality will not be able to generate sufficient own revenue and is increasingly dependent on subsidies and grants from other spheres of government. The following graphs illustrate Bitou's relative position in comparison to other local municipalities in the district.

GRAPH 3: EDEN DM: COMPARATIVE ECONOMIC RISK



GRAPH 4: EDEN DM: COMPARATIVE HOUSEHOLD ABILITY TO PAY RISK



Household Infrastructure Perspective

20. The Infrastructure Index for Bitou Local Municipality increased from 0.80 to 0.83 in the period from 2004 to 2013. This is in comparison to a national improvement from 0.66 to 0.721 and an improvement in Eden from 0.84 to 0.887 in the same period.

21. With regard to Sanitation and Electricity, Bitou LM performed slightly better than the municipalities in Eden as a whole, and in the case of Water and Refuse Removal slightly worse.

22. Very formal (56.7%) and Formal (18.7%) together constitute 75.4% of dwelling types in the municipality. Informal dwellings constituted 20.6% in 2013.

23. In the Bitou LM the percentage of households with access to a level of service of RDP or higher is higher than the percentage of households with income above the Equitable Share Bracket, i.e. 83.0% vs. 75.8%. The gap between household level of service and household income in the Bitou Local Municipality is a high 7.2 percentage points. Based on this gap Bitou Local Municipality will experience affordability concerns in future.

24. The non-revenue water for the Bitou LM was an unacceptably high percentage of 40.4% in 2010. The percentage of Non-revenue Water has increased since 2008. This is not sustainable and needs to be addressed as a matter of urgency.

Financial Perspective

25. On reflection of the historical financial performance as documented in the Updated Independent Financial Analysis attached in Annexure 1 it is important to take into consideration the financial strengths and weaknesses of Bitou highlighted in this report and to inform the Long Term Financial Plan.

26. Bitou has accumulated R 253 million from Accounting Profits over a term of 12 years; Bitou has however also invested R 602 million into Capital Infrastructure. This was financed by means of Capital Grants totalling R 294 million, External Financing of R 170 million and Own Cash Reserves of R 169 million. Minimal use was made of the Sale of Fixed Assets to fund Capital Investment.

27. Interest Bearing Debt in the form of loans has increased to R 133 million by 30 June 2014. Simultaneously provision for Employee Benefits has increased to R 92 million. The short term portion hereof, which needs to be cash backed, decreased by 13%.

28. The relationship between Current Assets and Current Liabilities has improved steadily year on year from 2010/11 to 2013/14. The positive improvement is reflected in the liquidity ratio of 1.59:1 for 2013/14 from a low level of 0.52:1 in 2010/11. This level sufficiently meets the minimum level required and should preferably be maintained or improved to at least 2:1. Current Liabilities have decreased as a result of declining unspent conditional grants. It is recommended that Bitou adopt a Liquidity Policy to guide the restoration and maintenance of liquidity.

29. Unspent Conditional Grants decreased from R 25 million to R 1 million in 2013/14.

30. The Consumer Debtors book increased by R 64 million when compared to 2002/03. Bitou prudently provides for 96% of all debtors older than 90 days. The collection ratio has however been fluctuating between 90% and 100%. The ratio has improved to 96%

and it would be preferable if at least this level could be maintained. Annual increases in billed income are far above inflation and may become unaffordable for the Consumer in the medium term.

31. Total Expenditure closely lags behind Total Income. Total Income grew by R 385 million in 12 years, whilst Total Operating Expenditure grew by R 322 million.

32. Bitou has over a 12 year term posted annual Accounting Operating Surpluses. Bitou has also shown the ability to generate Cash Operating Surpluses, however the levels hereof have reduced from above R 30 million to below R 10 million per annum, thereby reducing the own resources from which Bitou can generate the necessary cash provisions and increase the Capital Replacement Reserve for future capital spending.

33. Bitou's three main sources of revenue are derived from Electricity (27%), Property Rates (26%) and Water Services Income (10%). There has been a gradual increase in Equitable Share from 2% of Total Operating Revenue to 8% thereof.

34. Employee Costs (34%) and Electricity Bulk Purchases (19%) are Bitou's largest expenses, collectively totalling 53% thereof.

35. Repairs and maintenance is at levels of 3% of Total Operating Expenditure and is considered too low. This annual allocation should be revised upwards to ensure the health of the Infrastructure Assets.

36. Gearing increased to 34% in 2011/12 and as a result Interest Paid to Total Operating Expenditure has also increased to 4% per annum. Gearing is not excessive but is perceived to have reached the maximum affordable level for Bitou at this point in time.

37. Investment income has positively increased as a result of higher Cash and Investment Balances in recent years. However the escalating interest paid on Long Term Loans far exceed the interest income earned.

38. Bitou had a more aggressive capital spending approach between 2007/08 and 2010/11. Going forward this may mean that Bitou will have a reduced level of capital spending in the short term. It would be prudent for Bitou to adopt a Borrowing, Funds and Reserves policy to ensure the appropriate use of fiscal transfers, external gearing and own cash resources.

39. A Minimum Liquidity Policy is recommended to ensure that Bitou at all times holds sufficient Cash and Investments to provide for all statutory requirements and at least one month of operating expenditure. As at 30 June 2014 Bitou had a shortfall of R 8

million in accomplishing this objective. In the Medium Term, Bitou should be able to achieve this more conservative objective.

40. Bitou's credit score deteriorated annually from a BBB+ in 2008/09 (investment grade) to a BB+ (non-investment grade) in 2011/12. Subsequently Bitou has over the past two years implemented good financial governance and as a consequence improved its credit score to BBB. It would be prudent to manage the credit score at this level if not improving on it even further.

3. ISSUES IDENTIFIED

41. The list below is the result of a synthesis of issues identified during conversations with representatives of each Department on 26 and 27 May 2014. These matters were raised by officials of the Municipality and provide valuable insight into the environment within which the Municipality operates. The observations of the officials and interpreted by IPM for purposes of this report, provide insight into material issues that may impact on the longer term financial position of Bitou LM. The views expressed are those of the officials and IPM does not necessarily agree.

42. Service delivery

Without implementing expensive economic development programmes itself, the municipality can best serve the objective of diversifying the economy, drawing investors and thereby curbing unemployment by providing exceptionally high level of services, e.g. by reducing turnaround times for the approval of plans, reducing response times and generally provide its core functions to the best of its abilities. Providing services proactively by anticipating where development will occur, will further add to improved service delivery.

The proposed new developments in the health and educational sector as well as the proposed new court and correctional facility together with the municipal services will add to a package of public services that can attract investors - if delivered at good quality.

43. Integrated Asset Management

Whereas the potential of integrated asset management was acknowledged, the municipality's asset register was seen as only a tool for accounting. It is proposed that asset components are clearly identified and their location recorded, that the costs of repairs and maintenance, rehabilitation and replacement are properly accounted for and recorded against the relevant asset component. This should also assist in clarifying the confusion that currently exists in the definition of "new"-, "replacement"- or "repairs and maintenance" expenditure on assets. The view was expressed that too much attention is given to moveable (office) assets at the expense of infrastructure assets.

It is proposed that within the next 4 years, the asset register progress from merely an accounting tool to a comprehensive asset management system. This can be achieved in stages, viz.:

Maturity	Minimum	Core	Intermediate	Advanced
Asset Register	• Basic physical information • Recorded on a spread sheet or similar • Based on broad assumptions or incomplete	• Hierarchy • Identification • Asset attributes • Asset life • Information complete for asset valuation • Replacement Cost	• Reliable register • Physical & financial attributes • Information system with reporting functionality • Systematic data collection • High level of confidence	• Work history – type & cost • Condition • Performance at component level • Systematic & optimised data collection • Complete database for critical assets • Minimum assumptions for non-critical assets
Asset Condition	• Assessment at asset group level • Supports minimum requirements for critical assets and statutory requirements	• Assessment programme for major asset types • Data supports asset life assessment • Data standards and processes	• Assessment derived from C/B analysis • Good range of data for all asset types • Data management processes integrated into business processes • Data validation process in place	• Quality & completeness of data • Supports risk management • Supports life-cycle decision-making • Supports financial performance reporting • Reviews

FIGURE 2: MIGRATION OF INTEGRATED ASSET MANAGEMENT

44. Costing

The setting of tariffs (year on year escalation) is largely a response to the balancing of the budget. There is a gap in understanding the actual costs that underpin these tariffs. There is a medium term need to improve the understanding of actual costs and set tariffs accordingly, including appropriate margins on top of the costs of providing services.

Another reason for an improved understanding of the costs is to quantify the extent to which the municipality is subsidising the delivery of services to indigents. There is a suspicion that this is not fully understood.

With the fast growth in the provision of low income housing, the maintenance burden of associated infrastructure is catching up with the municipality. The lack of a proper costing system, which captures the actual costs incurred on the maintenance of asset components, including labour, materials and equipment costs make the quantification of repairs and maintenance inaccurate.

There is an acceptance that the introduction of a comprehensive costing system would be beneficial for the municipality. Confirmation was given that the IT systems of the municipality could be adapted to incorporate such a system.

45. Expenditure Curbing / Revenue Enhancing Measures

According to some officials certain expenditure items could be targeted for potential savings, viz.:

- Reduce the financial support to the Tourism Office which should rely more on revenue generated by its events and contributions from the private sector
- Reduce / eliminate the municipality's financial contribution to ad hoc programmes and events that are not included in the municipality's core functions
- Put measures in place, consisting of engineering solutions (meters, valves, etc.), education programmes and stricter credit control to prevent excessive water & electricity losses
- Overtime and standby pay to be reviewed and better control exercised to ensure that this is not abused
- Ensure that value for money is received from contractors, by thoroughly scrutinising tenders and monitoring the implementation of contracts
- Consider the rationalisation of staff in the Law Enforcement-, Waste Management- and Finance Departments

Enhancing the revenue sources could generate additional revenue for the municipality:

- Full cost recovery of all airport services (e.g. weekend fire services) must be aimed for through an increase of landing fees, parking fees and other/new relevant fees
- The deterioration through lack of maintenance of non-revenue generating infrastructure, viz. roads and stormwater should be countered by a levy added to property rates dedicated for this purpose
- In instances where the municipality has excess capacity available consider charging out these resources to outside parties at profitable rates, e.g. infrastructure for wireless communication
- Where the municipality provides bulk metering to developments, consider the potential of metering and billing of individual tenants separately at higher tariffs for the same amount of service
- The level of service provided to sub-economic housing is higher than required by national government. In an attempt to recover at least parts of these costs and introduce a culture of payment, a levy on households with RDP housing is proposed. This would also present a differentiating mechanism where households with lower levels of service pay less.

46. Waste Management

It is estimated that the use of the regional waste site at the PetroSA location costs close to R400 000 per month in dumping fees and transport costs. Whereas the long term environmental impact of a new- and/or expanded landfill site in Bitou may be unacceptable, the costs of utilising the regional site, as well as the capital costs of transfer stations and trucks needs to be recovered from users. It is expected that the tariffs for the refuse removal and waste management will escalate exponentially in future. Although the 10-year contract with Eden DM is only in its infancy, all possible alternatives should be investigated with the aim of minimising expenditure in the long term. In any event the municipality will have to prepare itself for a structural adjustment of the refuse removal tariffs.

47. Fire & Rescue Services

It has been noted that Bitou does not comply with the minimum standards of fire delivery services in its area of jurisdiction. In a report dated April 2013 to the Minister of Local Government in the Western Cape the inadequate resourcing of this function was recorded. This manifests itself in a shortage of human resources, ageing vehicles and equipment and unmanned fire sub-station (Kurland). In the light of the additional burden of performing the fire services normally expected of a District municipality (viz. bush fires), protecting vulnerable informal settlements and weekend services at the airport, specific attention to the resourcing of this function is required.

48. Consolidated Municipal Infrastructure Plan ("CMIP")

The municipality needs a consolidated municipal infrastructure plan including long term capital expenditure budgets. This plan can then be updated annually with the latest information on asset replacement and provision of new infrastructure.

The Spatial Development Framework ("SDF") should be used as a guideline for any new developments. Together these plans, viz. SDF and CMIP will provide more certainty on infrastructure requirements into the future.

49. Water & Electricity Losses

The officials report that the water and electricity losses were extremely high in the past. Although a variety of solutions are possible, including the "3-Es", viz. Enforcement, Education and Engineering, the municipality first needs to understand the reasons for the losses.

In the case of the example quoted in which 6 meters on one site were not picked up, the integration of systems between different departments e.g. Engineering and

Finance may be a solution as this will ensure that all information is captured correctly regarding new installations, cut-offs etc.

50. Middle Income Housing

The view was expressed that the housing choices in Bitou are limited to either high income or low income housing and that there is a shortage of middle income housing. The provision of the full spectrum of housing would make Bitou more attractive to investors. This would also benefit public servants expected to relocate to Bitou once the proposed magisterial court, provincial health facilities, correctional service facilities and schools are developed.

51. Staffing

There is an expectation that the complement of staff is not balanced. In some areas the number of staff per function is too much (e.g. refuse collection) whereas in others the number of staff is at critically low levels (e.g. electricians). The need for a comprehensive study on staffing requirements is proposed, by identifying the core business areas in which the municipality needs to perform and staff these functions appropriately. A preliminary estimate is that a saving of up to 10% of the funded staff numbers can be achieved, i.e. a rationalisation of approximately 50 people may be achieved.

There is an opportunity in the medium to long term to multi skill some staff for purposes multi-tasking. Concern was expressed that contractors appointed to cut grass, clean beaches, paint or provide catering are excessively expensive. Consideration should be given to either multi-skill the labour force to do many of these jobs or put in better controls to ensure that the municipality receives value for money from its contractors.

The outsourcing of certain functions, e.g. security services when the municipality has its own law enforcement capacity needs to be re-evaluated. The opinion was expressed that either the one or the other should be sufficient and that both could be regarded as wasteful expenditure. Questions were also raised at the effectiveness of running the tourism office when the need is to diversify the economy in Bitou.

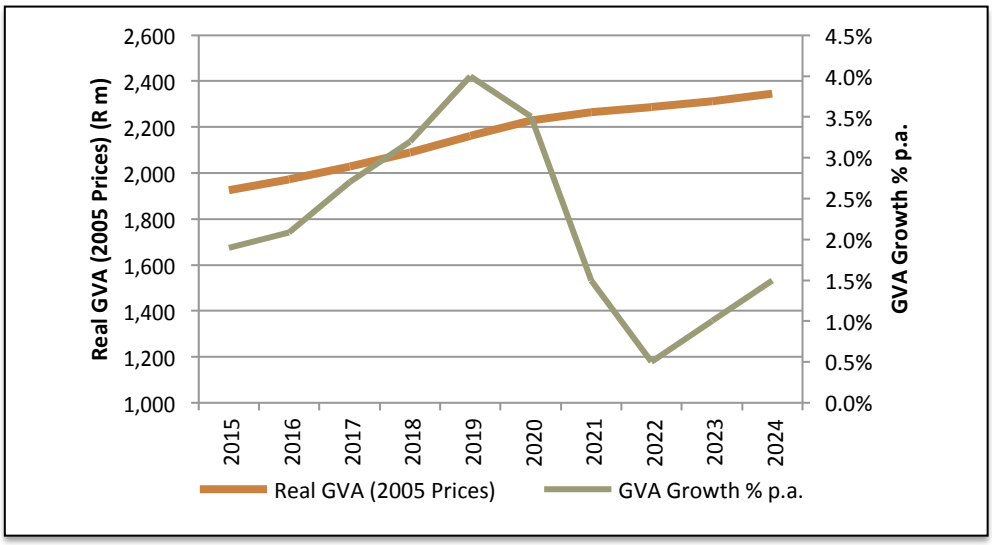
Savings could also be achieved by eliminating many of the programmes and events conducted by the municipality, viz. HIV/AIDS, Young Peoples Programme, June 16 Event, etc.

4. FUTURE MUNICIPAL REVENUES

52. In proposing a long term financial plan, IPM estimated the future municipal revenues. This projection was done with reference to the research done by Schoeman[3].

53. The future Gross Value Add ("GVA") of the Bitou LM was estimated based on a view of the future economic growth of the region and the cyclical nature thereof as well as an estimate of future population of Bitou. The graph below illustrates the Base Case GVA and GVA growth rates used in IPM's model:

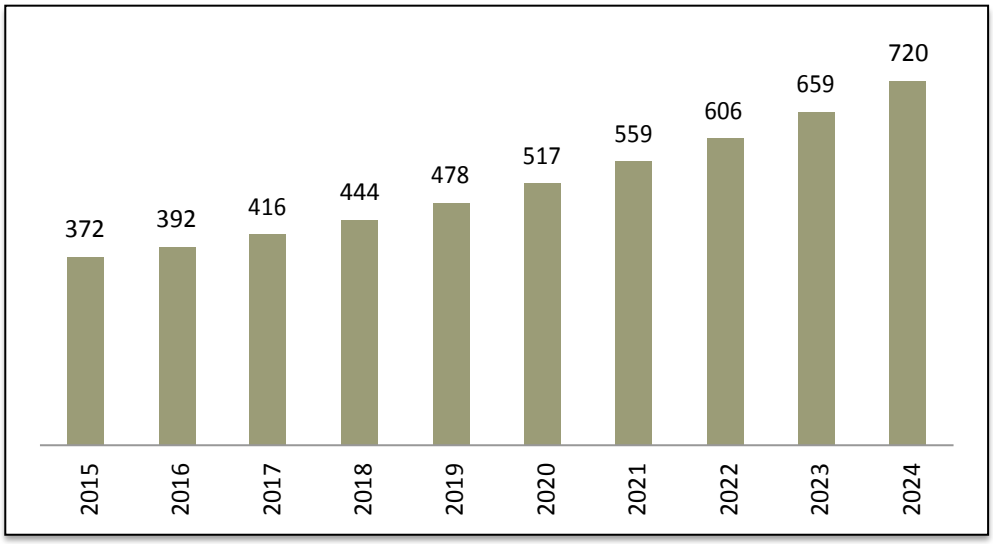
GRAPH 5: BITOU LM: GVA FORECAST



54. The future Municipal Revenue was then calculated by employing the relationship between Municipal Revenues ("MR"), GVA and Population, i.e. MR = f (GVA, Population). This estimate was calibrated against the municipality's forecast of future revenues in its MTREF. The estimated 10-year municipal revenues (excluding grants) for Bitou are illustrated in the graph below:

[3] *Fiscal Performance of Local Government in South Africa - an Empirical Analysis*; Niek Schoeman; UP 22 July 2011; https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=IIPF67&paper_id=40

GRAPH 6: BITOU LM: FORECAST NOMINAL MUNICIPAL REVENUE EXCL. GRANTS, RM P.A.



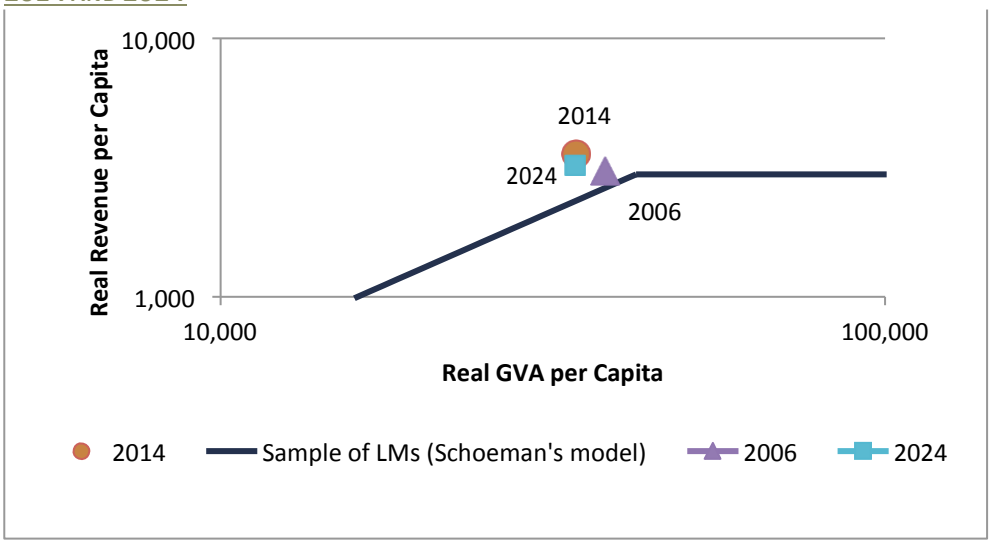
55. This represents an average annual nominal growth of municipal revenue of 8.1% p.a. over the 10 year period, and is made up of increased revenues due to increased quantities of services delivered and sold, new revenue sources as well as increase in tariffs.

56. No structural change in the economy of Bitou is expected that could influence the municipal revenues for the next 10 years significantly, e.g. no major industrial-, mining- or other major investment is expected in the region. Those investments / developments that do materialise (viz. the proposed Government Precinct) are accounted for in the GVA growth figure, which is assumed to average out at 2.2% p.a. for the next 10 years.

57. It is revealing to compare Bitou's Real Municipal Revenue per Capita with the Real GVA per Capita over time (viz. 2006 and 2014) to the sample of municipalities used by Schoeman in his research. For a decrease in GVA per capita the revenues per capita have increased over the 8 year period. The projected positioning in 2024 is still higher than the model developed by Schoeman[4] (as presented by the lines in the graph) but the gap is closing. We are comfortable with this trend in the light of the population growth rate of indigents exceeding that of affluent households.

[4] *Fiscal Performance of Local Government in South Africa - an Empirical Analysis*; Niek Schoeman; UP 22 July 2011; https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=IIPF67&paper_id=40

GRAPH 7: BITOU LM: REAL REVENUE PER CAPITA VS. REAL GVA PER CAPITA FOR 2006, 2014 AND 2024

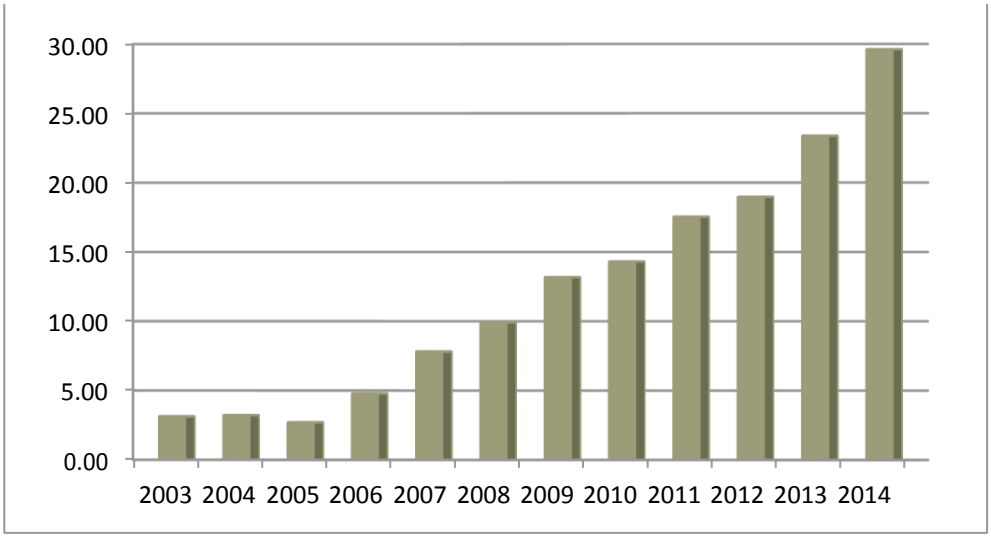


58. We conclude that Bitou LM's own revenue per capita has increased notwithstanding a decrease in GVA per capita during the same period (2006 to 2014). Already the Real Revenue per Capita exceeds the expected revenues for a similar size economy in Schoeman's model, and indicates that little opportunity exists to increase revenues per capita significantly in future.

59. Once the annual municipal revenues were determined the ability of the municipality to pay for operational- and capital expenditure and the level of expenditure was estimated based on a range of assumptions, as discussed in more detail further on in this report.

60. The predicted municipal revenues exclude grants and subsidies, as these are not dependent on the local economy. However, the model does take grants into account by adding back operational grants as well as capital grants in the funding mix, based on historical trends. The total unconditional grants (equitable share) received by Bitou LM in the past have grown consistently per annum since 2006, as illustrated in the graph below.

GRAPH 8: BITOU LM: NON-CAPITAL GRANTS AND SUBSIDIES P.A. (RM)



5. FUTURE OPERATIONAL EXPENDITURE

61. As the review of the current expenditure trends of Bitou has indicated there is limited scope to substantially increase any costs without negatively impacting on the overall operational performance of the Municipality, therefor requiring stringent management of the increases in current expenses.

62. Whilst the operational income curve has been growing at a relatively stable incline, operating expenditure has on the other hand shown a similar escalating pattern. Resulting in a squeeze on Cash Operating Surpluses. The irregular operational performance of Bitou is seen in the varying accounting and cash surpluses or deficits year on year, with no stable pattern seen in either indicator.

63. In this light it is important that any future variations in expenditure needs to be closely monitored and where possible the impact needs to be anticipated and staggered over multiple years to reduce the impact. This will enable Bitou Municipality to stabilise its financial position and continue the turnaround in the operational performance.

64. For Bitou to truly make a positive impact on its financial position, specific and in-depth attention has to be drawn to expenditure patterns and it will be imperative that expenses are effectively managed to ensure a positive operational performance.

65. Salaries, Wages and Allowances will remain high, approaching the upper limit of 40% as a percentage of Total Operating Expenditure proposed by National Treasury. Further it is anticipated that expenses will be managed with escalations in the order of 6%-9%. This would be beneficial but is far below historic increases which will require active monitoring of actual outcomes.

66. Every expenditure line item should be reviewed and in particular the increases in Salaries, Wages and Allowances, the low level of Repairs and Maintenance and general expenses which are expenses other than:

- Salaries, wages and allowances (inclusive of Councillors)
- Expenditure for Electricity Services
- Expenditure for Water Services
- Debt Impairment
- Depreciation
- Repairs and maintenance
- Finance charges

6. DEMAND FOR FUTURE CAPITAL EXPENDITURE

67. Integrated asset management acknowledges the link between the 3 elements of cost associated with asset management, viz. New Capital Expenditure, Asset Replacement Cost and Repairs and Maintenance Expenditure. The extension of the life of an asset beyond its Useful Life may save on Replacement Costs but will increase the Repairs and Maintenance expenditure. Any new assets created will also have an impact on the Repairs and Maintenance budget in future.

68. By analysing the asset registers and reviewing the IDP and various sector master plans of the municipality a feel for the demand of future replacement cost of exiting assets and investments in new assets was obtained.

Asset Replacement Expenditure

69. The "Replacement Cost" at a future "Replacement Date" for all the assets in the asset registers was determined. "Replacement" could also imply rehabilitation, enhancement (upgrade) or renewal (refurbishment) of that asset, but excludes routine repairs and maintenance.

70. The calculation is done mechanistically and does not cater for engineering judgement. The model only uses the Estimated Useful Life of the asset component as a criterion. The model calculates the Replacement Cost of assets for a 10 year period, i.e. up to and including 2024[5]. All assets, excluding "Land" was reviewed for replacement.

71. The outcome of this analysis is presented in the table below:

[5] The asset replacement costs were escalated up to the date of replacement. This is the reason why our amounts are significantly higher than for instance the replacement estimates in the WSDP in which the "Purchase Price" was quoted.